

# Counsel Beware — Sanctions for Failure to Disclose Can Be Severe: Lessons from *Rambus* and *Arista*

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*Two recent cases highlight the import of preserving and disclosing documents that may be relevant in intellectual property litigation. The authors caution all involved in intellectual property cases to beware the pitfalls, as sanctions can be imposed for a variety of reasons, and penalties can be particularly severe where courts have the power to render patents unenforceable.*

**M**icron v. Rambus and Arista v. Usenet.com are two recent intellectual property (“IP”) cases that highlight the dangers lurking for those who fail to understand and take seriously their obligations to preserve or disclose documents that may be relevant to litigation. There are lessons in these cases for IP and non-IP attorneys alike, and for both in-house and outside counsel.

Penalties can be particularly severe in the intellectual property context, where courts have the power to render patents unenforceable. Sanc-

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tions can be imposed for a variety of errors, including discovery abuse and improper implementation of document retention policies. Pitfalls exist whether you or your client is plaintiff or defendant, now or in the future.

### **CASE 1: *MICRON v. RAMBUS***

On January 9, 2009, a federal judge sanctioned Rambus, Inc. for its bad faith spoliation of evidence by rendering 12 of its patents unenforceable against Micron Technology, Inc.<sup>1</sup>

#### **Patent Licensing and Litigation Strategy**

Rambus is a technology company that had developed and patented dynamic random access memory (“DRAM”) technology, which it hoped would achieve industrywide adoption.

In an effort to strengthen its position relative to its competitors in the DRAM market, Rambus developed plans to create a patent “minefield” to gain an advantage over other companies in its industry. As part of its plan, in 1997 Rambus hired Joel Karp as Vice President of Intellectual Property, and tasked him with working on a licensing program for non-Rambus technologies that Rambus said infringed on their patents.

In March 1998, Karp met with outside counsel and discussed preparing trial graphics, retaining experts, and gathering critical documents to build legal cases against potential targets such as Micron, Fujitsu, Samsung, and Hyundai. As part of its strategy, Rambus planned to litigate against someone to establish a royalty rate and have a court declare the Rambus patents valid.

Following his meetings with outside counsel, Karp presented his licensing strategy to the Rambus board and explained the litigation strategy if licensing efforts failed. Rambus would use litigation to induce infringing parties to pay a premium licensing fee to Rambus.

#### **Document Retention Policy**

Karp proposed creating a document retention policy as part of the preparations for what he characterized as the “upcoming battle.” The poli-

cy covered such matters as how often files were backed up, how long they were kept, and where they were stored. One reason for implementing the retention policy was to reduce the volume of documents and e-mails that might otherwise be discoverable in litigation. For instance, Karp issued a memorandum directing that backup tapes be kept for only three months and that any data saved longer than that be separately archived.

The new retention policy was not implemented consistently. Against the advice of outside counsel, Karp instructed employees to “LOOK FOR THINGS TO KEEP” in order to help establish and prove the validity of Rambus’ intellectual property.

### **“Shred Days”**

After discussing the licensing and litigation strategy with its board, Rambus began holding “shred days.” On the first such day, Rambus destroyed an estimated 400 banker’s boxes-worth of documents relating to contracting and licensing negotiations, patent prosecution, board meetings, and finances. Rambus destroyed another 300 boxes of documents in August 1999. In the spring of 1999, Karp hired outside counsel to help in-house patent counsel purge Rambus’ patent files of hard and electronic copies of draft amendments, draft claims, and attorneys’ handwritten notes, even though these kinds of materials are typically sought in discovery in patent cases.

### **Litigation**

In June 1999, the United States Patent and Trademark Office (“USPTO”) issued Rambus’ ‘105 patent, the earliest-issued of the patents-in-suit. Karp now began a program of reverse engineering suspected infringing devices and developing a litigation strategy against several competing manufacturers. By September 1999, Rambus’ relationship with one of its key licensing targets, Intel, had begun to fray. The Rambus leadership decided to assert its IP rights aggressively to increase the industry’s perception of their value. Rambus settled on Hitachi as its first target, and, with the help of a third outside law firm, sued Hitachi in January 2000. By June 2000, Rambus and Hitachi reached a settlement that included a licensing agreement.

On August 24, 2000, Rambus initiated licensing talks with Micron. Micron responded by filing suit against Rambus seeking declaratory relief. Notwithstanding the fact that litigation had commenced, on December 28, 2000 Rambus shredded as many as 480 boxes of documents in connection with an office move.

### **Duty and Breach**

Micron moved the court to sanction Rambus for the spoliation of evidence. The court granted the motion, concluding that litigation was reasonably foreseeable to Rambus no later than December 1998, when Karp articulated a time frame and motive for implementing the Rambus litigation strategy. The court further found that, because the document retention policy was discussed and adopted in the context of Rambus' litigation strategy, Rambus knew or should have known that implementation of the policy was inappropriate because at least some of the documents destroyed would be subject to future discovery. Accordingly, the court found that the duty to preserve potentially relevant evidence arose no later than December 1998 and held that any documents destroyed from that time forward were destroyed intentionally and in bad faith.

### **Sanctions**

The court found that documents were destroyed that would have been discoverable in the litigation. Micron asserted defenses of patent misuse and inequitable conduct which could be established from internal Rambus documents. Because Rambus had possessed documents relevant to those defenses which no longer existed when Micron sought them in discovery, the court found that Micron had been prejudiced by the document destruction.

Weighing the degree of prejudice suffered by Micron and the severity of Rambus' bad faith, and seeking "the least harsh sanction" that would avoid substantial unfairness to Micron but would also serve as a sufficient deterrent of future behavior, the court declared the Rambus patents-in-suit unenforceable against Micron. The court reasoned that any lesser sanction, such as adverse jury instructions or preclusion of evidence, would be "impractical, bordering on meaningless, under these circumstances."

## **CASE 2: ARISTA RECORDS v. USENET.COM**

On January 26, 2009, a federal judge sanctioned Usenet.com Inc. for its bad faith spoliation of evidence in a copyright infringement suit brought by Arista Records LLC. The court deemed certain facts established, precluded defendant from challenging certain statistical evidence presented by plaintiff, and awarded plaintiffs their attorney fees.<sup>2</sup>

### **Alleged Copyright Infringement**

The defendant, Gerald Reynolds, operates a web site at <http://www.usenet.com/> that provides users with fee-based access to more than 120,000 newsgroups. Plaintiffs, Arista Records, et al., alleged that Usenet.com users upload copies of digital music files to Usenet's servers, where they are processed by Usenet.com and then shared with other Usenet.com subscribers. The plaintiffs sought injunctive and monetary relief for both direct and secondary copyright infringement.

### **Discovery Misconduct**

Plaintiffs moved for sanctions based on defendants' alleged spoliation of several categories of evidence, including: (1) "usage data" reflecting requests from paid subscribers to upload and download digital music files; (2) the actual digital music files; and (3) allegedly "highly incriminating" promotional materials that were at one time available on the Usenet.com web site.

Plaintiffs argued that defendants were on notice of their duty to preserve evidence as early as August 2007, when plaintiffs sent Usenet.com a written notice of infringement. Arista filed suit on October 12, 2007 and subsequently served discovery requests for the usage data, among other things.

Between March 8, 2008 and March 12, 2008, Arista and Usenet.com engaged in a series of calls addressing both the production of Usenet.com evidence and possible settlement. On March 8, 2008, defendants' counsel acknowledged the relevance of the usage data and agreed to produce it. That same day, however, Usenet.com disabled user access to an estimated

900 music groups at least in part because Arista insisted that Usenet.com disable access to infringing newsgroups as a condition of settlement. In disabling access, Usenet.com, however, failed to preserve evidence of newsgroup activity. Usenet.com argued that much of the data was transitory, and it lacked the ability to capture and preserve it.

In addition to failing to preserve the usage data and the digital music files, Arista alleged that promotional materials that were at one time available on the Usenet.com web site were destroyed following the commencement of the lawsuit.

## **Duty and Breach**

Exercising its inherent power to sanction defendants for the spoliation of evidence, the court found: (1) that defendants had control of the evidence and a duty to preserve it at the time it was lost or destroyed; (2) that defendants acted with a “culpable state of mind” when the evidence was lost or destroyed; and (3) that the lost evidence was “relevant” to the plaintiffs’ claims.

The court held that the duty to preserve evidence arose no later than the date the complaint was filed, and possibly earlier, when defendants received plaintiffs’ notice of infringement.

The court rejected defendants’ argument that they had no duty to preserve the data because it was “transitory.” Distinguishing this case from other cases dealing with “ephemeral” data, the court held there was a duty to preserve the evidence because: (1) the data here was “specifically requested prior to its destruction”; (2) the data—although transitory—remained on defendants’ servers for an average of 90 days; and (3) defendants’ claims that it was unable to preserve the data were belied by the fact that they were subsequently able to produce similar data.

## **Sanctions**

In an effort to avoid sanctions, Usenet.com submitted expert testimony on Usenet.com’s technology and network to support its claims that the data could not be preserved and that the volume of usage data and digital files was limited. Arista successfully challenged many of the expert’s conclu-

sions because they were based on information obtained from Reynolds, and were not independently verified. Although the court accepted some of Usenet.com's expert testimony, the sanctions imposed by the court were severe. The court deemed established: (1) that each of plaintiffs' copyrighted works that has appeared in one of Usenet.com's disabled music groups has been transmitted from defendants' servers to the personal computers of defendants' subscribers; (2) the disabled music groups constituted a substantial portion of the content previously available through Usenet.com; and (3) the music groups acted as a draw to entice subscribers to defendants' service. The court also prohibited Usenet.com from challenging plaintiff's statistical evidence of the volume of infringing activity on the Usenet.com service. Finally, the court awarded plaintiffs attorney fees.

The court reasoned that the adverse inferences and preclusion of evidence were appropriate because they restored plaintiffs to the position they would have been in absent defendants' wrongful spoliation of newsgroup usage data and digital music files.

## LESSONS FOR LAWYERS AND CLIENTS

These decisions provide important lessons for both in-house and outside counsel:

- The sanctions for failure to preserve can be devastating, including refusal to enforce patents or other intellectual property rights.
- Both plaintiffs and defendants need to consider the duty to preserve — when it attaches, and the scale of its scope — as soon as they become aware of possible litigation.
- For defendants, the timing of attachment may be easier to determine; it is often tied to a complaint or a threat of suit. For prospective plaintiffs, it may be more difficult to identify the moment the duty to preserve attaches. *Rambus* suggests that the duty arises at least as early as a company articulates a motive and timeframe for pursuing a litigation strategy. The prudent approach is to start preserving documents when a party begins planning for and taking active steps to prepare to file a lawsuit.

- There is no exception to the duty to preserve for “bad documents.” A plaintiff’s duty to preserve covers materials that may be sought by defendants in discovery to support defenses to the claim of infringement, including invalidity, fraud on the patent office, inequitable conduct, patent misuse, waiver, and estoppel. A defendant’s duty to preserve includes documents that support the plaintiff’s claim.
- A proper document retention policy is based on ordinary business needs, completely separate from any litigation considerations. Whatever the normal document retention program, once there is reasonable anticipation of litigation, potentially relevant documents that would ordinarily be destroyed in the ordinary course of business must be preserved.
- Coordination between a party and its outside counsel is essential. *Arista* illustrates how a failure to communicate can have serious consequences.
- Parties can also seek guidance from the court where, as in *Arista*, there is tension between a (purported) desire to “stop infringing” by ceasing the behavior sued for, while also preserving transitory data that may be relevant to the opposing party’s case.
- Usenet.com’s problems might have been avoided altogether if it had retained a consultant or e-discovery vendor to assist it in evaluating its preservation options (and costs) and provide independent expert testimony as to what actions it took to satisfy its duty to preserve. Bringing in an expert after the fact may not be sufficient, as Usenet.com learned the hard way.

With the advent of rules governing the discovery of electronically stored information (“ESI”) and the enormous costs of preserving, collecting, processing, reviewing, and producing ESI in litigation, many companies have been revamping their records management programs, instituting and enforcing the destruction of documents and other materials that have no continuing value for the business. Where the costs of document discovery can be as high as two-thirds of the total cost of litigation, such programs are essential components of good firm management. However,



companies and their counsel need to develop policies and procedures to disseminate notice as soon as litigation is contemplated so that legal, records management, IT, and other stakeholders can work together to identify potentially relevant information, implement litigation holds to preserve such information, and modify systems and procedures to prevent the automatic or inadvertent loss of any such information

## NOTES

<sup>1</sup> *Micron Technology, Inc. v. Rambus Inc.*, Civ. No. 00-792-SLR (U.S.D.C., D. Del., opinion and order filed Jan. 9, 2009). On March 11, 2009, Rambus filed a notice of appeal to the Federal Circuit.

<sup>2</sup> *Arista Records LLC v. Usenet.com Inc.*, No. 07-cv-8822-HB (TH K) (U.S.D.C., S.D.N.Y., order filed Jan. 26, 2009).